



DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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Statement of
LUIS P. SALAVERIA
Director

Department of Business, Economic Development, and Tourism
before the
HOUSE COMMITTEE ON FINANCE

Thursday, April 2, 2015
2:00 p.m.
State Capitol, Conference Room 308

in consideration of
SB118, SD1, HD1

RELATING TO REAL ESTATE INVESTMENT TRUSTS.

Chair Luke, Vice Chair Nishimoto, and Members of the Committee.

The Department of Business, Economic Development & Tourism (DBEDT) offers comments on SB118, SD1, HD1, which would require DBEDT to study the impact of real estate investment trusts (REIT), and requires a REIT to make an affirmative election to be taxed as a REIT and provide certain data to DBEDT for producing reports to the legislature.

DBEDT **appreciates the overall intent** of this bill, but would like to provide the following comments:

1. Timing of the report. The effective date of the law which is July 1, 2015, and the required reporting date of at least 20 days before the 2016 regular legislative session which is around December 15, 2015, is too soon for the 2015 Tax Year. The 2015 Tax Year return filing deadline is April 20, 2016. Many of the taxpayers may not have started filing their tax returns until after December 31, 2015. Therefore, the data, if any, would be incomplete and the usefulness of analysis would be questionable.
2. For the thirteen additional categories of data required by the bill, none of them currently exist. While data could be obtained through surveys of REIT businesses and Hawaii taxpayers, the results may be biased.

3. Not all Hawaii taxpayers who invest in REITs can be identified by the surveys due to the fact that many taxpayers invest in REITs through mutual funds. Mutual Funds may not be required to report detailed investment information.
4. The surveys of the businesses and Hawaii tax payers, as well as developing web filing of the data, data compilation, and report preparation would cost \$160,000.

Thank you for the opportunity to offer comments on SB118, SD1, HD1.

DAVID Y. IGE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

STATE OF HAWAII
DEPARTMENT OF TAXATION
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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Wednesday, April 2, 2015
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 118, S.D. 1, H.D. 1, Relating to Real Estate Investment Trusts

The Department of Taxation (Department) provides the following comments regarding S.B. 118, S.D. 1, H.D. 1 for your consideration.

The original version of this measure would have amended the corporation income tax by taxing Real Estate Investment Trusts (REITs) without regard to the federal deduction for dividends paid. The Senate Committee on Ways and Means amended this measure to instead to require the Department of Business, Economic Development, and Tourism (DBEDT), in conjunction with the Department, to study the impact of REITs in Hawaii and the possible effect of repealing the dividends paid income tax deduction. In particular, the study is to determine:

- (1) The total number of real estate investment trusts that operate in Hawaii;
- (2) Of that total in (1) above, the number that are Hawaii-based;
- (3) The number of Hawaii taxpayers who are investors in real estate investment trusts that operate in Hawaii;
- (4) The number of Hawaii taxpayers who are investors in Hawaii-based real estate investment trusts that operate in Hawaii;
- (5) A breakdown of Hawaii taxpayers who are investors in Hawaii-based real estate investment trusts that operate in Hawaii, by filing status and income;
- (6) The direct and indirect impacts of real estate investment trusts on the Hawaii economy, especially in real estate development and operation;
- (7) A comprehensive examination of captive real estate investment trusts for companies operating in Hawaii;
- (8) An examination of the argument that real estate investment trusts provide opportunities for small investors to pool funds with others and invest in real estate developments, similar to investments through mutual funds invested in company stocks;
- (9) An examination of the possible transfer pricing if the dividend paid income tax

- deduction for real estate investment trusts is repealed;
- (10) An examination of the equity and efficiency of the dividends paid income tax deduction for real estate investment trusts;
- (11) The projected tax revenue impact to the State if the dividends paid income tax deduction for real estate investment trusts is repealed;
- (12) The impact on the real estate development market and capacity if the dividends paid income tax deduction for real estate investment trusts is repealed; and
- (13) The impact on the economy of the State if the dividends paid income tax deduction for real estate investment trusts is repealed.

The report is due to the Legislature not later than twenty days prior to the convening of the regular session of 2016. The Department defers to DBEDT as to whether it can complete the requested study.

The Department would like to note, however, that some of the information that may be needed by DBEDT to conduct the study is not currently available; therefore, the report will not be able to address all of the issues noted in the measure.

For example, the Department does not currently track which corporations file an income tax return as a REIT. For Hawaii tax purposes, a REIT files a standard corporation income tax return, just as any other 'C' corporation would file. The Department has not required a REIT to identify itself as such. Therefore, in order to identify a REIT, the Department must add additional information requirements to the tax form. Because the tax forms for tax year 2014 have already been approved and printed, the earliest tax year for which this information can be obtained would be for the 2015 tax year.

Tax returns for the 2015 tax year are due on or before the 20th day of the 4th month following the close of the taxable year. Thus, a REIT that has a year end of December 31 would not be required to file its 2015 income tax return until April 20, 2016, well after the start of the 2016 Legislative session. In addition, corporations may elect to file their returns up to 6 months after the April due date of the return, which many corporations elect to take. Consequently, the information sought will not be available any earlier than 2017.

The Department also notes that many mutual funds invest in REITs. Consequently, a Hawaii taxpayer may receive dividends from a REIT indirectly when such taxpayer receives dividend from a mutual fund that has investments in REITs. Mutual funds are creations of federal law and are subject to an extensive and detailed regulatory regime set as forth in the Investment Company Act of 1940. As such, a mutual fund cannot be compelled to provide information on the number of Hawaii taxpayers investing in such fund or the amount of income attributable to a REIT operating in Hawaii. As a result, the report will be incomplete.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Real estate investment trusts

BILL NUMBER: SB 118, HD-1

INTRODUCED BY: House Committees on Consumer Protection and Commerce and Judiciary

BRIEF SUMMARY: Amends HRS section 235-71 to a real estate investment trust to make an affirmative election to be taxed as a real estate investment trust and provide certain data as may be required by the department of business, economic development and tourism (DBEDT) for any report mandated by the legislature.

Requires DBEDT, with the assistance of the department of taxation, to study the impact of real estate investment trusts in Hawaii and the effect of repealing the dividends paid income tax deduction for state income tax purposes.

Appropriates \$_____ in general funds for fiscal 2016 to DBEDT to conduct a study on real estate investment trusts in Hawaii.

EFFECTIVE DATE: July 1, 2015

STAFF COMMENTS: Currently under federal and state income tax law, a real estate investment trust (REIT) is allowed a dividend paid deduction, unlike most other corporations, resulting in that dividend being taxed once, to the recipient, rather than to the paying corporation. While the original measure would have made that section of the IRC inoperative for Hawaii income tax purposes for tax years beginning after 12/31/15, meaning that REITs would be subject to double taxation similar to other corporations, this measure is merely a study of the impact of REITS in Hawaii.

All state income tax systems in the United States, including ours, have a set of rules that are used to figure out which state has the primary right to tax income. For example, most tax systems say that rent from real property is sourced at the location of the property, so if a couple in Florida rents out a property they own on Maui they can expect to pay our GET and our net income tax on that rent. These sourcing rules, which do vary by state but are relatively consistent across state lines, are there to assure consistent and fair treatment between states.

Sourcing rules, however, can yield strange results. Here, there is a Hawaii Supreme Court case saying that when real property is sold on the installment basis under an “agreement of sale,” where the seller remains on title until the price is paid (although the buyer can live in the house), then the interest on the deferred payments is Hawaii source income and is subject to our net income tax and our GET. There is also a Hawaii Tax Appeal Court case holding that when the seller instead finances the deal by taking a purchase money mortgage on the property, and does not remain on title, then the mortgage interest is sourced to the residence of the seller, who in that case did not live in Hawaii. In the second case the court applied the rule for income from intangibles such as interest, royalties, and dividends, which says

that income is sourced to the residence of the recipient unless you can connect it with some active business that the recipient is conducting somewhere else.

Real estate investment trusts (REITs) are source shifters. For income tax purposes, they take in rent income, which is sourced to the location of the property being rented. They don't pay income tax on that income as long as they distribute the money to their shareholders as dividends. The dividend income of their shareholders, on the other hand, is generally sourced to the residence of the shareholders. So the income that the property states expected to tax is instead taxed in the states in which the shareholders live. And, to the extent that REIT shares are held by tax-exempt entities such as labor unions and retirement funds, passive income such as dividends may not be taxed at all. Source shifting is an issue specific to state taxation.

Apparently the evil sought to be addressed by the bill is that REITs are in Hawaii, but do not get taxed because of the deduction allowed for dividends paid, while many REIT owners who receive the dividend income are either outside of Hawaii and don't get taxed either because they are outside of Hawaii, or are exempt organizations that normally are not taxed on their dividend income. Normally we like to have our income tax law conform to the Internal Revenue Code to make it easier for people and companies to comply with it, but our legislature has departed from conformity when there's a good reason to do so (such as if it is costing us too much money). The issue is whether such a good reason exists here.

REITs do pay general excise and property taxes on rents received and property owned – as do the rest of us who are fortunate enough to have rental income or property to our name.

The committee on Ways and Means could not obtain data on the economic impact of REITs in Hawaii and their impact on tax revenue in the state, so the measure directs DBEDT to conduct a comprehensive study on REITs including any recommended legislation.

Digested 4/1/15



March 31, 2015

Representative Sylvia J. Luke, Chair
Representative Scott Y. Nishimoto, Vice Chair
House Committee on Finance

Testimony in Support of SB 118, SD1, HD1, Relating to Real Estate Investment Trusts (REITs); Dividends Paid Deduction (DPD); Income Tax; and Department of Business, Economic Development and Tourism (DBEDT) Study.

Thursday, April 2, 2015, 2:00 p.m., in Conference Room 308

The Land Use Research Foundation of Hawaii (LURF) is a private, non-profit research and trade association whose members include major Hawaii landowners, developers and a utility company. LURF's mission is to advocate for reasonable, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources, and public health and safety.

SB 118, SD1, HD1. In view of controversy surrounding the possible disallowance of the DPD for REITs, this bill proposes to require, and appropriate funds for the DBEDT to study the impact of such trusts and the disallowance of the DPD in Hawaii. This measure also requires a REIT to make an affirmative election to be taxed as a REIT and provide certain data as may be required for any report mandated by the Legislature.

LURF's Position. Given that an unwarranted change of such a universal tax rule in place since 1960 may adversely affect investments currently made by REITs in Hawaii; significantly reduce the availability of capital in this State; and result in other undesirable, damaging economic repercussions, LURF concurs that it is advisable and prudent for the Legislature, prior to considering the disallowance of the DPD, to require support for such a proposal in the form of a study or studies containing material facts proving that the State's economy will not be negatively affected as a result of the taking of such action. Specific inquiries may include how much money the State would actually receive as a result of the passage of legislation disallowing the DPD,¹ especially given the

¹ LURF understands that the State Department of Taxation currently does not even know how much money the government might gain from the disallowance of the DPD.

likelihood that REIT investment in Hawaii will in turn, decline (i.e., whether the proposed measure is fiscally reasonable); and whether it would be possible to replace the billions of dollars currently being invested in this State by REITs.

LURF agrees with proponents of this bill that it would be irresponsible and indefensible for lawmakers to pass legislation which may potentially stifle, if not reverse the current growth of the State's economy, without first conducting a thorough review and analysis of all the facts and information relating to the disallowance of the DPD for REITs, as well as the potential consequences thereof.

For the reasons stated above, and with the understanding that stakeholders, particularly those which are required by this measure to provide data for any report or study, will be included in discussions with, and allowed to provide input to those governmental agencies in connection with such reports and studies, LURF **supports SB 118, SD1, HD1**, and recommends passage of the bill by this Committee.

Thank you for the opportunity to provide testimony regarding this proposed measure.

WRITTEN TESTIMONY OF

ASHLEY H. PEEPER,
VP OF TAX

and

JOSEPH T. JOHNSON,
CHIEF FINANCIAL OFFICER

CNL LIFESTYLE PROPERTIES, INC.

BEFORE THE HAWAII HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCE

HONORABLE SYLVIA LUKE, CHAIR
HONORABLE SCOTT Y. NISHIMOTO, VICE CHAIR

HEARING ON S.B. 118, H.D. 1

APRIL 2, 2015

On behalf of our shareholders, we thank you for this opportunity to voice our opinion on H.B. 82 and its companion S.B. 118. We represent CNL Lifestyle Properties, Inc. (“CLP”), a real estate investment trust, or “REIT”, which owns Wet ‘N’ Wild Hawaii located in Kapolei, Hawaii. CLP is an unlisted publicly owned REIT that invests in lifestyle related properties such as ski resorts, gated attractions, waterparks, marinas, and healthcare facilities. CLP, like most REITs, has a long-term investment focus and is committed to creating sustainable value at its properties. CLP leases many of its properties under long-term leases to operators who are highly qualified in each of their respective industries. For example, we have leased Wet ‘N’ Wild Hawaii to an affiliate of Premier Parks, LLC which owns and operates several amusement and water parks throughout the United States. Because CLP has a long-term investment objective, we lease our properties on a long-term basis, as we have done here in Hawaii, typically for 20 years with multiple renewal extensions.

Modeled after mutual funds, Congress created REITs in 1960 to allow even the smallest investor to own and benefit from professionally managed, institutional quality, income-producing real estate. CLP currently has approximately 93,000 shareholders which are comprised of mostly individual or family owners, with few or no institutional investors. As with all REITs, CLP must meet many strict and costly requirements in order to maintain its status as a REIT. For example, REITs must distribute at least 90% of their taxable income annually, shares must be transferrable, they cannot be “closely held”, they cannot “flip” properties without being subject to a 100% tax on the gain, and they cannot provide more than a small amount of tenant-specific services (like maid service in apartments) without jeopardizing REIT status. For this reason, REITs are not “unfairly” advantaged; they face additional burdens for which they receive the benefit of the dividends paid deduction.

S.B. 118, as originally proposed, would have eliminated what is known as the dividends paid deduction (or DPD) for all REITs operating in Hawaii. As amended, S.B. 118, H.D. 1 provided for a study regarding the impact of REITs operating in Hawaii. The bill, however, was further amended to require any REIT filing a tax return in Hawaii to file an affirmative REIT election in Hawaii, and, at a minimum, to provide detailed information on (1) the total number of investors in the REIT and the amount of dividends paid to those investors, (2) the total number of Hawaii taxpayers who are direct investors in the REIT and the total amount of dividends paid to those investors, and (3) whether such REIT is ‘captive’ meaning, a REIT that is not regularly traded on an established securities market (e.g. the New York Stock Exchange) and where more than 50% of the voting stock is owned by a single entity treated as a taxable corporation. The failure to provide this information would invalidate the REIT election and, therefore, the ability of the REIT to claim the DPD for Hawaii corporate income tax purposes.

As a practical matter, publicly listed REITs are not required to and will not be able to identify “the total number of Hawaii taxpayers who are direct investors in that REIT and the amounts paid to those investors” and will therefore automatically be prohibited from the DPD. CLP, a non-traded REIT, may be able to compile this information but it will not be without significant additional time and effort.

The elimination of the DPD, or the effective eliminate of the DPD due to the need to provide burdensome information, would be inconsistent with federal tax rules and the existing rules of virtually all other states with an income based tax system. Additionally, we believe that our investment and the investments by other REITs in Hawaii are beneficial to the state and that such a tax would have the undesirable consequence of discouraging additional investments in the future. We strongly believe the proposed legislation’s lack of conformity with the federal tax rules and the tax rules of most other states will diminish competitiveness of Hawaii to attract and to retain capital investments. If Hawaii repeals or

effectively eliminates the dividends paid deduction, Hawaii would no longer be viewed as an attractive place for REIT investments by the market place.

CLP acquired Wet ‘N’ Wild Hawaii (formerly known as Hawaiian Waters) for \$15 million in May 2009. Since that time, we have worked to identify capital improvements and maintenance projects to enhance the park experience and to make the water park even more successful. To that end, we have since invested several million additional dollars in the park to make enhancements and improvements which helps to draw both local residents and vacationers to the park.

CLP believes that its ownership of Wet ‘N’ Wild Hawaii and its motivation to continue to invest in the waterpark benefits the State of Hawaii in many ways, including:

- **JOBS.** Wet ‘N’ Wild Hawaii employs more than 350 employees with payroll and benefits in excess of \$1.7 million.
- **CAPITAL IMPROVEMENTS.** Given the long-term nature of our investment and the structure of our leases, we are motivated (provided we are not subsequently discouraged by state tax law) to make sizeable investments to achieve orderly, sustainable growth at our properties. Waterpark infrastructure is expensive to both acquire and maintain which is a key reason there are so few waterparks in existence. Our principal investment objective is to preserve, protect, and enhance the long-term value of our assets. CLP is positioned to make, and has made, sizeable investments after it purchases waterparks because our REIT business model does not depend on a “quick flip” sale of the resort or high “private equity” level returns to our investors. This is why we have invested more than \$3 million to install new rides, including a family friendly raft ride and a state of the art racing slide. We also have plans to make an additional investment of \$750,000 to install a new waterslide in during 2015.
- **CAPITAL MAINTENANCE.** The existing infrastructure of a waterpark is extensive and costly to maintain on an annual basis. Once a property has fallen behind on maintenance, repair, and replacement schedules, a waterpark can begin a downward spiral of its annual business volume. Our REIT business model and structure of our tenant leases ensure we do not neglect this critical obligation. In fact, since it acquired the property in May 2009, CLP has invested more than \$1.7 million for repair and maintenance items, including –
 - Refurbishment of pools and slides,
 - New pumps and equipment for rides,
 - New filtration systems for the pools,
 - New restaurant equipment, and
 - Parking lot refurbishment.
- **STABILITY.** CLP’s focus is to create stability for both its shareholders, the State of Hawaii, as well as for the communities and families that depend on the economic contribution provided by Wet ‘N’ Wild Hawaii. To this end, CLP’s stated target leverage ratio is not to exceed 50%. Market demands placed on public REITs have compelled REIT managers to use debt conservatively, which means properties do not have to be managed solely to generate the cash flow required to service high levels of debt. Our low leverage ratio gives us greater control over our assets, complementing and enhancing our investment view. A lower debt versus equity ratio cushions

CLP (and other REITs) from the negative effects of fluctuations in the real estate market that have traditionally occurred over time.

- **TAXES GENERATED BY WET 'N' WILD HAWAII.** CLP's ownership of this prominent Hawaii property produces substantial tax revenue for Hawaii – revenue that will grow if continued investment motivation is not diminished by this ill-advised proposed legislation:
 - **Payroll Taxes.** Payroll taxes on employee wages totaled \$197,208 in 2014.
 - **General Excise and Use Tax – Property Operations.** The tax revenues in this category totaled \$497,060 in 2014.
 - **General Excise and Use Tax – Rent.** Because CLP is a REIT and must use a lease structure, we are required to pay General Excise Tax on the rent received for both real and personal property. This tax was approximately \$127,000 for 2013 and \$117,000 for 2014.
 - **Gas Taxes.** State taxes paid on gasoline purchases by guests traveling to and from the park.
 - **Property Taxes.** CLP paid approximately \$285,000 in property tax for 2014.
 - **Transfer Taxes.** CLP paid a transfer tax of \$62,000 when it acquired the waterpark.
 - **Taxes on Seller's Gain in Connection with Properties Sold to REITs.**
 - **Dividend Taxes Paid by REIT Investors.** REIT investors currently pay tax on their dividend income in their state of residence. The current system allows the State of Hawaii to collect taxes annually from REIT shareholders in Hawaii through personal state income taxes no matter where the REIT does business. By adopting HB 82 / SB 118 and imposing a tax at the corporate REIT level, Hawaii would reduce the amount of cash ultimately available to be paid to Hawaii investors, thus putting them at an economic disadvantage.

In addition, we believe that Wet 'N' Wild Hawaii further benefits the State of Hawaii and the island of Hawaii by creating an attractive amenity that helps draw visitors from the U.S. mainland, Japan and other locations.

In conclusion, though we do not oppose a study to analyze the impact of REITs in Hawaii as provided for in S.B. 118, S.D. 1, we strongly urge that Hawaii not impose double taxation on REITs. If adopted, this unwise legislation would (i) put Hawaii at a competitive disadvantage compared to virtually all other states, (ii) penalize Hawaii citizens who invest in REITs by reducing their returns, and (iii) discourage REITs from investing in Hawaii properties. Further, this legislation would have a chilling effect on the motivation of REITs, like CLP, which currently own property in Hawaii, to improve these assets and grow their positive economic impact through additional capital investment.

We thank you again for this opportunity to provide testimony strongly in opposition to S.B. 118, SD1, HD1. For all practical purposes, the bill as currently written eliminates the dividends paid deduction for REITs in Hawaii making it a less attractive place to invest.



April 1, 2015

Hearing Date: Thursday, April 2, 2015

Time: 2:00 pm

Place: State Capital, Conference Room 308

Hon. Sylvia Luke, Chair
House Committee on Finance

Hon. Scott Y. Nishimoto, Vice Chair
House Committee on Finance

State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to Senate Bill No. 118, SD1, HD1

Dear Chairman Luke, Vice Chairman Nishimoto, and Honorable Members of the House Committee on Finance:

Thank you for the opportunity to provide testimony on Senate Bill No. 118, SD1, HD1 which would require the Department of Business, Economic Development & Tourism ("DBEDT") and the Department of Taxation ("DOT") to study the impact of real estate investment trusts ("REITs") in Hawaii and the possible effect of repealing the dividends paid deduction for REITs.

We are Francis Cofran, the Senior General Manager of Ala Moana Center, the largest retail center in the state of Hawaii, and Sandeep Mathrani, the Chief Executive Officer of General Growth Properties, Inc. ("GGP").

As drafted, SB118, SD1, HD1 will require a REIT to make an affirmative election to qualify for the dividends paid deduction (DPD). The election would require the REIT to provide significant information to the Department of Business, Economic Development, and Tourism (DBEDT). We have significant concerns about the language of the Bill and the information required to be provided, as much of this information is impossible for a publicly traded REIT to obtain.

Section 1 of SB118, SD1, HD1 adds the following language to HRS §235-71(d):

- (2) A taxpayer shall make an affirmative election to be taxed as a real estate investment trust, and as a requirement of such election, shall provide pertinent data as may be required by the department of business, economic

development, and tourism solely for the purposes of producing any report mandated by the legislature. Failure to meet the requirements of this subsection shall invalidate the election to be taxed as a real estate investment trust. Such information at a minimum shall include:

- (A) The total number of investors in that real estate investment trust and the total amount of dividends paid to those investors;
- (B) The number of Hawaii taxpayers who are direct investors in that real estate trust and the total amount of dividends paid to those investors; . . .

There are a number of ambiguities and significant problems with this language:

1. It is unclear when the election must be made, when the information required by the election must be provided or what period the information is to cover.

a) The number of investors in a REIT is constantly changing, but the Bill doesn't indicate at what point in time the number of investors is to be determined.

b) For publicly traded REITS, a significant number of shares are held in "street" name with brokerage houses, so it may not even be possible, let alone practical, for a REIT to determine the number of investors at a given point in time.

c) The Bill does not specify the period for which the information provided regarding dividends paid to investors is to be provided. REIT investors are constantly changing and REITs do not track the ownership period for each individual investor or the total dividends paid to a particular investor for particular periods of time.

d) There is no coordination between the timing of the election and the information to be provided.

2. New subsection (d)(2)(B) to be added to HRS §235-71 references information to be provided regarding, "Hawaii investors who are direct investors". It is unclear what is meant by this requirement.

a) What is a "Hawaii investor"? Would a Hawaii pension plan count as a "Hawaii taxpayer" even if it does not pay Hawaii tax? What about ownership by a pass-through entity, such as a Hawaii LLC? What about shares held by a non-Hawaii LLC that is owned by Hawaii individuals?

b) What is a "direct investor"? Do shares held in street name by a Hawaii resident count? What about shares held by a non-Hawaii LLC, the members of which are Hawaii individuals?

3. Even if the meaning of "Hawaii investors who are direct investors" can be clarified, there is no way for a REIT to obtain and provide to DBEDT the information required for the election.

The considerations described under 1. above with respect to total investors are complicated by the additional level of detail required regarding Hawaii taxpayer status, to which information REITs are not privy. Therefore, REITs cannot determine the number of Hawaii investors who are direct investors or the amount of dividends paid to those investors.

The consequence of these new information requirements would be that the "election" created by SB118, SB1, HD1 would be illusory for publicly traded REITs, such as GGP and therefore the bill would have the effect of repealing the dividends repealed deduction for such REITs, changing the rules of REIT taxation under the guise of commissioning a study.

REITs have a significant real estate investment in Hawaii, which, in turn, produces substantial economic benefits, such as jobs, general excise tax on rents from tenants, general excise tax on sales of goods by tenants, income tax on profits from tenants, real property taxes, and individual income tax from employment of residents of Hawaii.

At Ala Moana Center, GGP has or will be investing almost \$1 billion in capital to construct additional retail square footage and luxury residential condominiums based on the existing Hawaiian tax regime. We are making this investment using local partners; Hawaiian Dredging is the general contractor for the retail expansion and The MacNaughton Group, The Kobayashi Group, and Blacksand Capital are our partners in the residential condominiums.

This \$1 billion investment is producing substantial benefits to the Hawaiian economy. During the construction period, we estimate economic activity of 11,600 full- and part-time jobs and over \$146 million of state revenue including indirect community benefits (known as the "ripple effect"). Post the construction period, the shopping center investment alone will produce an incremental \$33 million of state revenue and 3,000 jobs annually.

We are considering future expansion plans at Ala Moana Center that may be as much as an additional \$2 billion. However, we would need to reconsider whether this investment could be more profitably deployed elsewhere if SB118, SD1, HD1 was enacted. GGP evaluates investment opportunities throughout the United States, and the state tax implications of those investment opportunities impact our capital allocation decisions. The enactment of this Bill or other bills of this type ultimately reduce the attractiveness of investing in Hawaii.

For the foregoing reasons, we respectfully oppose SB118, SD1, HD1 and urge you to not let it move forward. Thank you for your consideration.

Sincerely,



Francis Cofran
Senior General Manager



Sandeep Mathrani
Chief Executive Officer



NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

WRITTEN TESTIMONY OF

DARA F. BERNSTEIN
SENIOR TAX COUNSEL
NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS
IN OPPOSITION TO S.B. 118, S.D. 1, H.D. 1

BEFORE THE HAWAII HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCE

HONORABLE SYLVIA LUKE, CHAIR
HONORABLE SCOTT Y. NISHIMOTO, VICE CHAIR

HEARING ON S.B. 118, S.D.1, H.D. 1

APRIL 2, 2015



The National Association of Real Estate Investment Trusts submits this testimony in opposition to S.B. 118, S.D. 1, H.D. 1, as currently drafted. NAREIT is the world-wide representative voice of real estate investment trusts (REITs) and publicly traded real estate companies in the United States. Although NAREIT does not oppose a study to evaluate the impact of REITs in Hawaii, NAREIT opposes the legislation as currently drafted because stock exchange-traded REITs would be unable to comply with its requirements.

S.B. 118, as originally proposed, would have eliminated what is known as the dividends paid deduction (or DPD) for all REITs operating in Hawaii. As amended and passed by the Hawaii Senate, S.B. 118, S.D. 1 provided for a study regarding the impact of REITs operating in Hawaii. However, the Committees on Consumer Protection & Commerce and Judiciary further amended S.B. 118 to require that any REIT filing a tax return in Hawaii file an affirmative REIT election in Hawaii, and, at a minimum, provide the following information: 1) the total number of investors in that REIT and the total amount of dividends paid to those investors; 2) the total number of Hawaii taxpayers who are direct investors in that REIT and the total amount of dividends paid to those investors; and, 3) whether such REIT is a "captive REIT". The term "captive REIT" is defined as a REIT that is not regularly traded on an established securities market and where fifty percent or more of the voting stock is owned or controlled, directly or indirectly, by a single entity treated as an association taxable as a corporation under the Internal Revenue Code that is not exempt from the federal income tax and is not itself a REIT. Failure to provide this required information, as well as any other information that may be required by the Department of Business, Economic Development and Tourism (DBEDT), would invalidate the REIT election, and, accordingly, the ability of the REIT to claim the DPD for Hawaii corporate income tax purposes.

Because REITs whose securities are traded on established securities markets (*e.g.*, the New York Stock Exchange or NASDAQ) will not be able to identify "the total number of Hawaii taxpayers who are direct investors in that REIT and the amount of dividends paid to those investors," as a practical matter, the legislation would invalidate the DPD for these companies.

In particular, like all publicly traded companies, the overwhelming majority of stock exchange-traded REIT shares are held in "street name" by a nominee who is not obligated to report the underlying shareholder identifying information to the REIT. In fact, for most companies, the registered shareholder that owns the majority of their stock is a company called DTC (Depository Trust & Clearing Corporation), and, more specifically, its affiliated company, "Cede & Co." (See <http://www.dtcc.com/asset-services/issuer-services/how-issuers-work-with-dtc.aspx> ("When an investor holds shares this way, the investor's name is listed on its brokerage firm's books as the beneficial owner of the shares. The brokerage firm's name is listed in DTC's ownership records. DTC's nominee name (Cede & Co.) is listed as the registered owner on the records of the issuer maintained by its transfer agent. DTC holds legal title to the securities and the ultimate investor is the beneficial owner.")).

There are certain public securities filings that are required of shareholders who own more than 5% of a publicly traded company. However, these shareholders tend to be large institutional investors such as mutual funds, which, like REITs, have pooled the capital of many investors to invest in their underlying portfolio of assets. In fact, mutual funds tend to own a significant percentage of stock in publicly traded REITs, and, in most, if not all cases, these REITs are unable to identify the ultimate shareholders of their mutual fund owners.



In fact, both the DBEDT and Department of Taxation (DOTAX) testimony with respect to an earlier version of this legislation, S.B. 118, S.D. 1, noted that many mutual funds invest in REITs. DOTAX specifically noted that "a mutual fund cannot be compelled to provide information on the number of Hawaii taxpayers investing in such fund or the amount of income attributable to a REIT operating in Hawaii. Therefore any report will not be able to provide all of the information as requested in this measure."

In addition, U.S. securities laws also require that "institutional money managers" that exercise investment discretion over \$100 million or more of publicly traded company securities (such institutional money managers include Bank of Hawaii or First Hawaiian Bank) must file a Form 13F with the U.S. Securities and Exchange Commission (SEC) listing their securities ownership. However, it is not possible to know whether the securities listed on these forms are owned directly by such money managers or on behalf of their underlying clients.

Because stock exchange-traded REITs would not be able to identify their direct Hawaii shareholders, they would be unable to comply with the requirements of this legislation, and the DPD would be invalidated for them.

Eliminating the DPD would be contrary to the federal income tax rules applying to widely-held REITs in every state with an income-based tax system like Hawaii except for New Hampshire. It is worth noting that although both Hawaii and New Hampshire have roughly equivalent contributions to the nation economy, REIT investment in Hawaii is about four times that of New Hampshire.

While those who support the legislation as originally proposed state that that investment money can be easily replaced, it is worth noting that as of December 2013, based on filings with the Securities and Exchange Commission, approximately twenty widely-held REITs (the majority of which are publicly traded companies whose shares are held in street name) invested about six billion dollars in commercial real estate in Hawaii that results in the employment of many Hawaii residents. The Hawaii real estate owned by REITs generates millions of dollars in property taxes and excise taxes. These taxes are on top of the individual income taxes currently generated by REIT dividends paid to Hawaii residents from income earned wherever the distributing REIT resides or does business. In addition, the sales generated by the tenants that conduct business on the premises owned and operated by REITs generate jobs and taxes as well.

Replacing a \$6 billion investment is not as easy as it looks and since tax-exempt organizations such as pension plans and endowments are major investors in large scale commercial real estate, these players would be the most likely to fill any vacuum created by REITs investing in other states. NAREIT believes that a carefully crafted study to analyze the impact of REITs in Hawaii would bring needed factual clarity to the benefits Hawaii obtains by maintaining conformity to virtually all other states regarding a REIT's DPD. However, as drafted, S.B. 118, S.D.1, H.D. 1 would not do so. As an alternative, NAREIT suggests that DBEDT be authorized to obtain the requisite information through statistical sampling and reasonable estimation methods.

Background of REITs. Congress created REITs in 1960 specifically to enable small investors to invest in professionally managed, income-producing real estate. REITs are corporations that combine capital of many investors to benefit from a diverse portfolio that may include apartments, hotels, healthcare facilities, shopping centers, senior housing, offices, storage facilities and warehouses. Federal law requires REITs to distribute all their taxable income to their shareholders. The billions of dollars distributed are taxable where the REIT shareholders reside. Hawaii residents invest in REITs



that own properties in Hawaii and REITs that own no properties in Hawaii but own properties in other states. The dividend income earned by Hawaii residents in Hawaii is taxed here even if the REIT invested in owns properties elsewhere. The workers who have jobs because of REITs pay income taxes in Hawaii, and the State receives the general excise taxes that this income generates through the purchase of goods and services.

Just Like Other Taxpayers Are Not Taxed On Mandatory Expenses Like Property Taxes, REITs Should Not Be Taxed on the Taxable Income They Cannot Retain. Hawaii allows taxpayers to deduct certain expenses like property taxes when calculating their taxable income. This is because taxpayers should not be taxed on the cash used to pay these expenses. Unlike other businesses, REITs are required to distribute all their income so this income is taxed at the shareholder level. As a result, REITs should not be taxed on money that they cannot keep.

For example, like other businesses, REITs have to pay property taxes. Thus, if both a REIT and non-REIT businesses have \$100 of rental income and \$10 of property taxes, they both get a \$10 deduction. Then, they are both left with \$90 (\$100-\$10). Unlike the other business, the REIT has to distribute the remaining \$90. Thus, it has no cash left. Here, it has distributed \$90, and is left with \$0 in cash; thus, it pays no tax for federal income tax purposes and for state tax purposes in states with corporate income taxes (other than New Hampshire).

Benefits to Hawaii. REITs, such as General Growth Properties, owner of the Ala Moana Shopping Center, and Taubman Centers Inc., the developer of the International Marketplace, have access to public capital markets to raise the large funds needed for such large development projects. The renovation and expansion of Ala Moana enjoys a commitment of over \$500 million while the International Marketplace project shows a commitment to invest over \$400 million on the part of Taubman. This redevelopment will result in about one thousand construction jobs and 2,500 permanent jobs and all the taxes that activity will produce. These jobs would have been put in jeopardy by the tax proposed as a result of S.B. 118, SD. 1, H.D. 1.

Hawaii investors also benefit from REITs. Between January 2010 and 2015, almost 11,000 Hawaii investors invested over \$380 million in around 70 SEC-registered, non-listed REITs, some of which have been sold or undergone initial public offerings. (Because the securities of these companies are not or were not listed on exchanges, their shares were not held in "street name," but were held in registered form on the books of the companies' transfer agent.) These companies have distributed approximately \$100 million to these Hawaii investors. In addition to investing in public, non-listed REITs, Hawaii investors invest in publicly traded REITs through mutual funds, particularly mutual funds dedicated to publicly traded REIT stock. In fact, thousands of Hawaii shareholders have invested about \$60 million in several dedicated REIT mutual funds sponsored by a single mutual fund company. (This information is not generally available, but was provided to NAREIT by the mutual fund company.) In 2014 their accounts received income and capital gain distributions totaling \$8.5 million. The State is collecting taxes on the millions of dollars distributed to Hawaii investors by these companies and funds that invest in REITs, even though almost all of the properties held by these REITs are located outside of Hawaii.

Except for New Hampshire, every other state that imposes a corporate-level income tax allows the DPD for widely-held REITs. It is hard to imagine Hawaii's position would be improved by partnering with New Hampshire as opposed to being seen as being aligned with the rest of the nation. If Hawaii repeals the DPD, Hawaii would not be viewed as an attractive place for REIT investments. As can be seen from the record, as opposed to the speculation on the part of the supporters of S.B. 118 as



originally proposed, the REIT investments have resulted in tremendous value and in jobs, all of which produces income for government and residents. Can Hawaii be assured that much of this investment will not be lost if the DPD is repealed? Logic says much of the investment would be lost.

For all practical purposes, SB. 118, S.D. 1, H. D. 1 would eliminate the DPD for REITs in Hawaii, even if a study is undertaken and recommends against eliminating the DPD. Accordingly, NAREIT respectfully opposes the study to analyze the impact of REITs in Hawaii as provided for in S.B. 118, S.D. 1, H.D. 1. Thank you again for the opportunity to submit this testimony.



The Twenty-Eighth Legislature
Regular Session of 2015

HOUSE OF REPRESENTATIVES
Committee on Finance
Rep. Sylvia Luke, Chair
Rep. Scott Y. Nishimoto, Vice Chair
State Capitol, Conference Room 308
Thursday, April 2, 2015; 2:00 p.m.

**STATEMENT OF THE ILWU LOCAL 142 ON S.B. 118, SD1, HD1
RELATING TO REAL ESTATE INVESTMENT TRUSTS**

The ILWU Local 142 supports S.B. 118, SD1, HD1, which requires and appropriates funds for DBEDT to study the impact of Real Estate Investment Trusts (REITs) and requires a REIT to make an affirmative election to be taxed as a REIT and provide certain data as may be required by DBEDT..

Hawaii is losing out on millions of dollars in taxes because of something called the dividends paid deduction that helps REITs as long as they distribute 90% of their taxable income to shareholders, who then pay taxes in their home states. Most of the REITs with real estate holdings in Hawaii have shareholders/investors who do not live in Hawaii. Since REITs themselves currently have a dividends paid deduction, and most shareholders reside outside of Hawaii, all of the income from the real estate activity of REITs in Hawaii goes to other states, and none of it remains in Hawaii.

Hawaii can certainly use another source of revenue. Requiring REITs to pay corporate income taxes would be one means of generating the revenues needed for services and programs needed to address the myriad of issues facing our residents—including public education and early childhood education, homelessness and affordable rental housing, support for the elderly and disabled, and access to quality health care.

Many involved with REITs have testified in opposition to repealing the deduction, citing the possibility of losing real estate investments. In our view, it is highly unlikely that a repeal of the deduction will mean that REITs will pull out of the Hawaii real estate market altogether. There are reasons why REITs invest in Hawaii—the deduction being but one small reason. And there are also reasons why everyone should pay their fair share of taxes to benefit the entire community. However, we agree with the Senate Committee on Ways and Means that more careful study and discussion is needed to determine the impact of taxing REITs before enacting legislation to repeal the deduction.

The ILWU urges passage of S.B. 118, SD1, HD1, which will provide for this study. Thank you for the opportunity to share our views on this measure.

finance1-Kim

From: mailinglist@capitol.hawaii.gov
Sent: Wednesday, April 01, 2015 12:40 PM
To: FINTestimony
Cc: sfletcher@tmghawaii.com
Subject: *Submitted testimony for SB118 on Apr 2, 2015 14:00PM*

SB118

Submitted on: 4/1/2015

Testimony for FIN on Apr 2, 2015 14:00PM in Conference Room 308

Submitted By	Organization	Testifier Position	Present at Hearing
The MacNaughton Group	The MacNaughton Group	Oppose	No

Comments:

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TESTIMONY BEFORE THE HOUSE
COMMITTEE ON FINANCE

DATE: APRIL 2, 2015

RE: SB 118, SD1, HD1 – REAL ESTATE INVESTMENT TRUST

PERSON TESTIFYING: WIL OKABE, PRESIDENT
HAWAII STATE TEACHERS ASSOCIATION

The Honorable Chair Sylvia Luke, Vice Chair Scott Nishimoto and Members of the Committee:

The Hawaii State Teachers Association (HSTA) **supports S.B. 118, SD1, HD1** relating to real estate investment trusts.

HSTA is the exclusive representative of more than 13,500 public and charter school teachers statewide. As the state affiliate of the 3.2 million members of the National Education Association, HSTA supports tax reform and believes that it should:

- A. Increase tax fairness and raise revenue necessary to finance quality public education and other public service;
- B. Eliminate regulations that shift the tax burden to the less affluent;
- C. Prevent excessive reliance on property tax or any other single tax;
- D. Reflect the findings off comprehensive studies of the total individual and corporate tax burden;
- E. Assure that statewide uniformity in property tax effort be required;
- F. Provide funding for public education that ensures adequacy and equity of resources;
- G. Not be used to place arbitrary maximum limits on any state or local government's ability to spend or tax, particularly since such limits have a negative impact on the full funding of schools;
- H. Attract expatriated businesses and investments to return the benefit to our American economy; and
- I. Encourage penalties to corporations that move their interests abroad to avoid tax liabilities.

Thank you for the opportunity to testify in **Support of S.B. 118, SD1, HD1.**

WHY DO YOU PAY STATE INCOME TAXES WHEN ALA MOANA CENTER DOESN'T?

In fact, General Growth Properties, the owner of AlaMoana Center, has paid no Hawaii income taxes since it acquired the lucrative property in 1999. The same goes for the owners of Pearlridge Center, Public Storage, Waialeale Center and Waialeale Outlet Shops, The Pali Safeway/Longs Center, Whaler's Village on Maui, Kuhio Mall on the Big Island, Ward Center, Ward Warehouse and another 280 properties in Hawaii. According to the National Association of Real Estate Investment Trusts (NAREIT), there is \$13.1 billion dollars of Hawaii real estate owned and controlled by mainland corporations that pay ZERO income tax in the state of Hawaii. This is because these corporations have elected to be taxed as Real Estate Investment Trusts (REITs) and since the early 60's our state has provided a loophole that helps these companies send almost one billion dollars a year to their mainland owners, untaxed.

REITs own a huge amount of property in Hawaii. All the land in Mapunapuna and large portions of land around Sand Island and in Campbell Industrial Park are owned by a single REIT. You may recall back in 2010 when tenants in Mapunapuna, including Grace Pacific, Servco, and Olelo Community Television, banded together to form the group called "Citizens for Fair Valuation," to file suit against the hostile practices of this mainland company. It adds insult to injury that this mainland owner has not ever paid a cent of income tax in Hawaii. A near majority of downtown class A office space is owned by REITs. So are the medical office buildings at PaliMomi and Kapiolani Hospitals. The Hyatt Waikiki, Waikiki Beach Walk, The Hyatt Regency Maui, The Fairmont Kea Lani, The Waikiki Marriott, The Marriott Hotel Kauai, and other hotels operate as REITs. The former Ward Estate portfolio owned by Howard Hughes is operated as a captive REIT. Even Wal Mart and some of the other big retailers have set up REITs that own their store buildings. All of the REITs mentioned above are based on the mainland, and their senior management and 99.5% of their shareholders live on the mainland. None of these corporations that elect to get taxed as REITs pay income taxes in the state of Hawaii. If I, or any local corporation, investor from Asia or private equity investor from the mainland, owned one of these properties, we would have a hefty tax bill from the State each year. But without that added cost, REITs can offer higher prices to acquire properties here, resulting in more and more REITs coming into the Hawaii market and displacing other tax paying investors.

It's time to close the REIT income tax loophole. Our state is losing at least \$50 million a year of corporate income taxes because of it. Only REITs have been allowed to deduct dividends paid in determining their taxable income. The REIT law intended that the taxes would be paid at the shareholder level, but 99.5 percent of the shareholders live on the mainland, so Hawaii never gets its share of the income tax generated by these properties. REITs may pay general excise tax, conveyance tax and real property taxes in Hawaii, but in the case of the retail, office and industrial properties, 100 percent of those taxes are passed on to the REITs' overburdened tenants; so the REITs effectively pay no taxes in Hawaii. Why should we give out-of-state investors a tax break that we don't give to our own local citizen-investors who are paying state income taxes ranging from 6.4 percent to 11 percent?

There is more REIT-owned property in Hawaii per capita than any other state in the nation, and by a wide margin. The REITs argue that if we tax them and make them pay their fair share of taxes, they will no longer invest here. That is simply not true. New Hampshire has taxed REITs for years and still the state of New Hampshire has more REIT-owned property per capita than the median U.S. state. If the REITs achieve a 7.5 percent return on their \$13.1 billion investment, that is around one billion dollars in net income that is not being taxed in Hawaii, before considering the tax on capital gains from the sale of trophy assets such as AlaMoana Center. Right now, if General Growth sold AlaMoana Center for a \$2 billion profit, the state of Hawaii would get nothing.

There is no reason why any investor in Hawaii should be operating tax-free when our state is struggling to pay for our children's education, services for our elderly, and to deliver promised benefits to its retirees. REITs don't pay sufficient taxes to support Hawaii's infrastructure and don't support our local charities in a meaningful way, then they ship our money out of state, tax free. There are plenty of local, mainland, and foreign tax-paying investors here, such as Alexander & Baldwin, Castle & Cooke, BlackSand Capital, Watumull Properties, MW Group, private equity funds, hedge funds, and mainland institutional investors. We should level the playing field and make REITs equal to other real estate investors in the way they are taxed. We need to protect our tax base for the benefit of our community.

Partial List of REITs Operating in Hawaii

- Hospitality Property Trust (Marriot Hotel Kauai)
- HRPT / Commonwealth / Select (Mapunapuna, Sand Island, Campbell Industrial Park, First Insurance Center, Pali Safeway / Longs, etc.)
- HR & Healthcare Realty Trust (HPH Office Building, Beretania Medical Office Building)
- Douglas Emmett (Bishop Square, Honolulu Club, 1132 Bishop Street, Harbor Court)
- General Growth (AlaMoana, Prince Kuhio Mall Kauai, Whalers Village)
- Starwood Hotels & Resorts
- Host Hotels & Resorts (Hyatt Regency Maui, Fairmont Kea Lani Maui)
- Simon Properties (Pearlridge Center, Waikele Outlets)
- American Assets Trust (The Shops at Kalakaua, Waikele Center, Waikiki Beach Walk)
- Public Storage
- Pacific Office Properties
- RLJ Lodging Trust (Waikiki Marriot)
- Lexington Realty Trust (Downtown Macy's Retail)
- Taubman (International Market Place)
- Portions of Howard Hughes
- Forest City
- DeBartolo Kapaeha